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William F. Caton, Acting Secretary  
Federal Communications Commission  
1919 M Street, N.W., Room 222  
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

Re: In the Matter of the Proposed Merger of  
MCI Communications Corporation and  
British Telecommunications plc,  
GN Docket No. 96-245

Dear Mr. Caton:

Enclosed for filing in this docket are the original and four copies of the Comments of BellSouth Corporation, Pacific Telesis Group, and SBC Communications Inc. Also included is a copy of the comments on diskette in WordPerfect 6.1 format. Please date-stamp and return the extra copy in the enclosed envelope.

If you have any questions concerning this matter, please contact me at (202) 326-7902.

Sincerely,

Michael K. Kellogg /gmK

Michael K. Kellogg

Enclosures

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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

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In the Matter of

The Proposed Merger of MCI  
Communications Corporation and  
British Telecommunications plc

GN Docket No. 96-245

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To: The Federal Communications Commission

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January 24, 1997

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## EXECUTIVE SUMMARY

The dominant local and national carrier in the United Kingdom, British Telecom ("BT"), here seeks permission to obtain control of one of the three major interexchange carriers in the United States. BT and MCI ask the Commission to approve their merger on the basis that it will bolster competition and yet bring no threat of anticompetitive effects, given that regulators have opened BT's historical monopoly to competition and adopted various regulatory safeguards. These arguments are flatly inconsistent with years of MCI rhetoric about Bell company entry into interLATA services. Indeed, should the Commission accept MCI's new position that open markets and pervasive regulation will adequately protect against potential misconduct by BT and ensure that the merger is consistent with the public interest, the Commission could not reasonably reach any different conclusion with respect to interLATA entry by the Bell companies.

The risks presented by Bell company interLATA entry are in fact significantly less than those presented by this merger. BT and MCI argue that the merged company could not use its position as the dominant local and national carrier to disadvantage U.S. competitors in the United Kingdom because telecommunications markets in the United Kingdom are "fully open" and "there is an elaborate and comprehensive set of competitive safeguards to prevent BT from acting anticompetitively." Applications and Notification at 7, 42. Yet the Telecommunications Act of 1996 (the "1996 Act") ensures that when Bell companies provide in-region interLATA services, their local markets will be more open to competition than are BT's domestic markets. Structural separation requirements and other statutory safeguards, together with equal access rules, price caps, and well-tested Commission cost-accounting procedures, likewise provide regulatory protection well beyond that imposed by British authorities. If potential competition and

regulation in the United Kingdom will prevent BT from engaging in anticompetitive conduct there, then they will suffice as well to protect against any potential harm from entry of the Bell companies as new long distance carriers.

Moreover, the public benefits certain to follow Bell company entry into interLATA services far exceed the asserted benefits of the BT/MCI merger. MCI's claimed benefits revolve around economies of scale and scope, and the entry of a well-financed, established carrier into markets that are not fully competitive. Those are the same benefits that would follow, in even greater measure, from Bell company entry into in-region interLATA services.

MCI's claims in this proceeding thus highlight the falsehood of its contrary insistence that excluding the Bell companies from interLATA markets would benefit consumers. MCI's cynical equation of its own self-interest with the public interest ought not to be credited. Instead, it should cause the Commission to scrutinize MCI's contradictory assertions in section 271 proceedings with particular care. Moreover, it is impossible to fathom how the public could benefit from keeping domestic new entrants out of the U.S. long distance market at the same time that a foreign company is permitted to enter the market by buying out one of the major incumbents. Thus, if the Commission finds that the BT/MCI merger is in the public interest, it effectively will have determined that Bell company entry pursuant to section 271 is consistent with the public interest as well.

**COMMENTS OF  
BELLSOUTH CORPORATION, PACIFIC TELESIS GROUP,  
AND SBC COMMUNICATIONS INC.**

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Just as it must consider the public interest in evaluating interLATA applications by Bell companies, so too must the Commission decide here whether BT's proposed acquisition of MCI is consistent with the public interest. Compare 47 U.S.C. § 271(d)(3)(C), with 47 U.S.C. §§ 214, 310(b). This proceeding involves an effort by a giant foreign carrier to enter the long distance and local telephone businesses in the United States, not as a new competitor, but by buying one of the incumbent interexchange oligopolists. BT and MCI argue that their merger will serve the public interest by integrating BT's resources and expertise as a local carrier with MCI's long distance operations. They may be right. But if so, then full interLATA entry by the Bell companies — domestic local exchange carriers who seek to provide long distance services as new entrants — necessarily will serve the public interest as well.

**I. BT'S DOMESTIC MARKETS ARE LESS OPEN TO COMPETITION THAN LOCAL MARKETS IN THE UNITED STATES AND BT OPERATES WITH LESS REGULATORY OVERSIGHT THAN THE BELL COMPANIES**

When dominant foreign carriers seek to enter the U.S. international services market, the Commission asks whether they might “leverage their market power into [that] market.” Market Entry and Regulation of Foreign-Affiliated Entities, 11 FCC 3873, 3875, ¶ 1 (1995) (“Foreign Carrier Rulemaking”). Specifically, the Commission “require[s] a foreign carrier to demonstrate that effective competitive opportunities exist [for U.S. competitors in the foreign country] before it can serve a destination market where it has market power.” Id. at 3890-91, ¶ 45. In order to ensure that U.S. carriers will not be victimized by discriminatory interconnection in that country or by cost misallocation, the Commission examines both the openness of the foreign carrier's

domestic markets, id. at 3893, ¶ 50, 3897, ¶ 61, and the adequacy of regulatory safeguards, id. 3893, ¶ 51, 3894, ¶ 54.

Such an inquiry is doubly important here because BT seeks not just to provide the U.S.-end of international services, but also to enter local markets in the United States. See Applications and Notification at 8-11. Under the principle that the public interest is served when U.S. carriers have effective competitive opportunities in the foreign markets that are the counterparts to the U.S. markets the foreign carrier seeks to enter, BT and MCI thus bear the burden of showing that BT's local markets are open to new, foreign entrants. Cf. Foreign Carrier Rulemaking, 11 FCC Rcd at 3944-45, ¶¶ 186-87 (extending effective competitive opportunities test to radio licenses).

This inquiry is similar to the one that the Commission will undertake in the course of its public interest inquiry when reviewing section 271 applications. In fact, objections to Bell company provision of in-region interLATA services are based on the very same alleged fears that BT and MCI try to assuage in their application: i.e., that control over home markets might be used to dominate interexchange markets through discrimination or cost misallocation.<sup>1</sup> These concerns are stronger in the case of BT, however; as the incumbent carrier throughout all of Britain, it supplies a much larger percentage of access services than any Bell company does in the United States. Whereas a large percentage of the interLATA calls that a Bell company would originate in its region will terminate outside that region, virtually every U.S./U.K. call that BT/MCI competes to originate in the United States will terminate within BT's local calling area.

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<sup>1</sup> See Notice of Proposed Rulemaking, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended, FCC 98-308, CC Dkt. No. 96-149, at ¶¶ 7-8 (rel. July 18, 1996) ("Non-Accounting Safeguards NPRM").

To address concerns about potential anticompetitive conduct, BT and MCI claim that BT is subject to strong competition and that “an elaborate and comprehensive set of competitive safeguards . . . protect[s] new US and other entrants into the UK telecommunications business from any possible BT abuse of power.” Applications and Notification at 42. They argue that competition and regulation in Britain would prevent BT/MCI from discriminating against U.S. carriers with respect to interconnection in the United Kingdom, and from misallocating costs between domestic and international operations.

Yet, in both areas, stronger protections would apply to Bell company interLATA entry. The Commission simply cannot credit that MCI’s merger with BT will be competitively benign, unless it is prepared to reject MCI’s sham arguments about Bell company entry into in-region interLATA services. The U.K. regime that MCI hails in this proceeding falls well short of the U.S. local competition requirements and regulatory safeguards that MCI assails as inadequate elsewhere.<sup>2</sup> The fact is that U.S. local markets now are more open than U.K. domestic markets, and Bell companies that enter in-region interLATA services will be subject to much greater safeguards than BT. If U.K. markets are sufficiently open and U.K. regulation is adequate to prevent BT/MCI from engaging in anticompetitive behavior against competitors in the United Kingdom, it follows that lower barriers to entry and more pervasive competitive safeguards in the

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<sup>2</sup> See, e.g., Comments of MCI Regarding the Requirements for InterLATA Entry Under Section 271, Investigation Regarding U S West Communication Inc.’s Compliance with Section 271 of the Telecommunications Act of 1996 with Respect to Provision of InterLATA Services Originating in Minnesota, Dkt No. P-421/CI-96-1114, at 24 (Minn. Pub. Util. Comm’n Nov. 25, 1996) (“MCI Minnesota Comments”) (“a BOC’s satisfaction of the checklist does not prove the existence of real competition”) (Ex. 1 hereto); MCI, The Effects of BOC Long Distance Entry on Competition in Local and Long Distance Markets at 8 (DOJ filed Dec. 13, 1996) (“MCI DOJ Comments”) (Ex. 2 hereto) (“Regulators cannot effectively prevent the BOCs from acting on . . . anticompetitive incentives.”).

United States will prevent the Bell companies from engaging in such behavior. A Commission finding in this proceeding that BT's acquisition of MCI is consistent with the public interest inevitably would lead to a finding in the section 271 context that Bell company interLATA entry also is consistent with the public interest.

**A. Barriers to Competitive Entry are Higher in BT's Home Markets than in U.S. Local Exchange Markets**

BT and MCI maintain that "the telecommunications market in the UK is fully open." Applications and Notification at 7; see also id. at 24, 31 (emphasizing openness and ability to compete). Yet, in the United Kingdom, competitors can offer an alternative to BT's services only if they sink the costs necessary to build extensive facilities-based networks. No such requirement exists in this country. To the contrary, the 1996 Act's resale and unbundled access provisions — from which MCI itself is benefitting — have eliminated this economic barrier to entry. See id. at 10 (noting MCI's plan to enter local markets through resale and use of unbundled elements).

Resale. The Commission has described resale as "an important entry strategy both in the short term for many new entrants as they build out their own facilities and for small businesses that cannot afford to compete in the local exchange market by purchasing unbundled elements or by building their own networks."<sup>3</sup> Yet a company cannot compete with BT in Britain's domestic markets if it does not have alternative facilities. BT is under no obligation to provide discounted wholesale services to pure resellers. Rather, it need only interconnect with certified facilities-

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<sup>3</sup> First Report and Order ¶ 32, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98 (FCC Aug. 8, 1996) ("Interconnection Order").

based carriers known as “Relevant Connectable Systems.”<sup>4</sup> By contrast, the 1996 Act requires each BOC to sell its local services to resellers at wholesale rates, thereby ensuring that carriers without their own facilities can compete. § 251(b)(1), (c)(4).

Unbundling. BT also is not obligated to provide unbundled access to elements of its network. The U.K. Office of Telecommunications recently rejected a proposal for “direct connection” that would have “allow[ed] other operators to take over the exchange line at some convenient point.” OFTEL Statement ¶ 41. OFTEL recognized that the proposal would have “open[ed] up a number of opportunities for operators to compete with BT without the substantial investment needed to lay individual connections and without undue risk to the new operator.” OFTEL Statement ¶ 41. Nevertheless, it retained the less stringent requirement that BT need only “establish and maintain one or more” points of interconnection for competing carriers’ networks. BT License ¶ 13.1(a), OFTEL Statement Annex A ¶ A1. OFTEL reasoned that allowing competitors to lease portions of BT’s network “would discourage rather than encourage operators to build their own Access Networks.” OFTEL Statement ¶ 45.

This is a far cry from the situation in the United States, where each incumbent local exchange carrier (“LEC”) must offer interconnection and unbundled network elements at “any technically feasible point,” § 251(c)(2), (3), as well as provide collocation to allow the most efficient combined use of the incumbent’s and competitor’s facilities. § 251(c)(6). These

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<sup>4</sup> See Statement Issued by the Director General of Telecommunications, OFTEL’s Policy on Indirect Access, Equal Access and Direct Connection to the Access Network Annex A ¶ A1 (July 1996) (“OFTEL Statement”) (Ex. 3 hereto) (citing conditions 13.1(a) and (c) of BT’s license); see also British Telecommunications, Form 20-F, at 16 (S.E.C. July 5, 1996) (“BT Form 20-F”) (Ex. 4 hereto); OFTEL, Promoting Competition in Services Over Telecommunications Networks ¶ 4.12 (“service providers applying for licenses . . . but not building their own network would not get RCS status”) (Ex. 5 hereto).

provisions not only enable carriers to compete while they are constructing their own facilities piece-by-piece, but also allow carriers with specialized expertise, or who see a narrow market opportunity, to offer their services without ever becoming full facilities-based carriers.

Moreover, under the Commission's current TELRIC pricing formula, or any comparable state scheme that would require Bell companies to provide interconnection at prices that do not recover fixed costs, Bell companies would be required effectively to subsidize BT/MCI's entry into U.S. local telephone markets. It could not possibly serve the public interest to require Bell companies to subsidize BT/MCI's entry into U.S. local markets, while protecting this foreign-owned carrier from home-grown Bell company competition in long distance.

Dialing Parity. The applicants try to sweep under the carpet another significant difference between U.K. domestic markets and U.S. local markets. The Commission has concluded that if customers of new entrants cannot dial the same number of digits regardless of the carrier they choose, competition will be curtailed. The Commission thus has emphasized "the critical importance of dialing parity to the successful introduction of competition in telecommunications markets." Interconnection Order ¶ 17. Yet a customer that chooses to use the services of one of BT's competitors must dial an access code that adds an extra four digits. OFTEL Statement ¶¶ 9, 23, 36-37. The 1996 Act, by contrast, requires the Bell companies to provide both local and intraLATA dialing parity to obtain interLATA authority. §§ 251(b)(3), 271(e)(2).

Pricing of Interconnection. As evidence that local U.K. markets are open, BT and MCI point out that BT's competitors have "access to BT's local network . . . at prices determined by OFTEL." Applications and Notification at 23. That simply puts BT's competitors in the same position as the Bell companies' local competitors, who can obtain interconnection at rates

governed by the 1996 Act's cost-based standard. § 252(d)(1). Regardless of whether the Commission or the state commissions ultimately are responsible for interpreting the Act's local pricing provisions,<sup>5</sup> the 1996 Act ensures that local competitors will receive interconnection and unbundled network elements (and resale as well) at rates that enable them to compete effectively.

In that regard, it should be noted that competitors are not entitled to interconnect with BT at the prices that MCI claims are essential for local competition in this country. In the U.K., BT successfully argued that a "long run incremental cost" pricing formula similar to that adopted by the Commission in its Interconnection Order would place BT in the untenable position of providing below-cost interconnection. BT explained "that any LRIC regime should be based on 'top down' costs," which take into account BT's actual expenses.<sup>6</sup> BT is in fact permitted to recover fixed, as well as variable costs.<sup>7</sup> Moreover, it has opposed a proposal that would limit its pricing flexibility by requiring it to recover fixed costs equally "across all types of service."<sup>8</sup>

Ironically, while BT has fought with regulators over the mechanism by which it will recover fixed costs, MCI has maintained that, in order for healthy local competition to develop, the Bell companies and other incumbent LECs in this country must not be permitted to recover their fixed costs at all. See Interconnection Order ¶¶ 655 & n.1615, 656.

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<sup>5</sup> See Iowa Utilities Bd. v. FCC, No. 96-3321, order at 13-16 (8<sup>th</sup> Cir. Oct. 15, 1996) (discussing state versus federal authority over prices).

<sup>6</sup> BT Response to OFTEL's Effective Competition: Framework for Action -- Ch. 2 ¶¶ 6-12, (Oct. 1995) ("BT OFTEL Response") (Ex. 6 hereto); see also Pricing of Telecommunications Services from 1997: OFTEL's Proposals for Price Control and Fair Trading ¶ 4.56- 4.59 (1996) ("OFTEL Pricing Proposals") (Ex. 7 hereto) (reconciling top-down and bottom-up models).

<sup>7</sup> BT Form 20-F at 12, 17.

<sup>8</sup> BT OFTEL Response ¶¶ 6-12.

## **B. Protections Against Cost Misallocation**

Regulatory protections against leveraging of incumbency likewise are more extensive in this country than in the U.K. Protections against cost misallocation are a good example.

Price Caps. Although MCI and BT rely on the “elaborate and comprehensive set of competitive safeguards” that governs BT’s activities, Applications and Notification at 42, they neglect to mention that one of the most important of all federal safeguards in the United States does not currently apply to interconnection in the United Kingdom.

The possibility that a carrier might shift costs incurred in adjacent businesses to regulated services arises only where regulators tie rates to costs. Non-Accounting Safeguards NPRM ¶ 7. Price cap regulation therefore essentially eliminates the risk that Bell companies might shift costs in such a manner. The Commission requires the Bell companies to reduce their rates by a set amount annually without regard for costs, thereby encouraging them to cut (rather than pad) the costs of regulated services: “Because cost savings do not trigger reductions in the cap, the firm has a powerful profit incentive to reduce costs. Nor is there any reward for shifting costs from unregulated activities into regulated ones, for the higher costs will not produce higher legal ceiling prices.” National Rural Telecom Ass’n v. FCC, 988 F.2d 174, 178 (D.C. Cir. 1993); see

Non-Accounting Safeguards NPRM ¶ 136.<sup>9</sup> Most states likewise have abandoned rate of return regulation in favor of price caps or comparable forms of “incentive regulation.”<sup>10</sup>

Although BT’s retail prices have been subject to some form of price cap regulation since 1984, BT Form 20-F at 19, regulators do not use price caps in regulating BT’s interconnection (i.e. access) charges. See Applications and Notification at 22. Instead, they employ a form of traditional rate-of-return regulation, setting BT’s interconnection charges so as “to cover [BT’s] fully allocated costs of conveyance, a full contribution to relevant overheads, and a return on capital employed.” BT Form 20-F, at 12, 17. MCI has said — in the context of Bell company entry into interLATA services — that any such system creates unacceptable incentives to misallocate costs.<sup>11</sup>

BT and MCI assert that OFTEL may in the future extend its current retail price cap regime to access charges. Applications and Notification at 22.<sup>12</sup> But OFTEL’s proposed price caps still would not be as protective of competition as Commission regulations. OFTEL has said

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<sup>9</sup> Moreover, by phasing out “sharings” in 1995, the Commission eliminated any attenuated link between profits and costs. BellSouth, Pacific Telesis, and SBC all have decided to adjust their price caps, rather than to participate in sharings, thereby confirming that sharings offer no real-world opportunities for misallocation. See Report and Order, Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, FCC 96-490, CC Dkt No. 96-150, at ¶ 267 & n. 654 (rel. Dec. 24, 1996) (“Accounting Safeguards Order”).

<sup>10</sup> See National Association of Regulatory Utility Commissioners, NARUC Report on the Status of Competition in Intrastate Telecommunications 180-81 (Oct. 4, 1995).

<sup>11</sup> See MCI’s Initial Comments to the Department of Justice Concerning the Motion to Vacate the Judgement and NYNEX’s Request to Provide Interexchange Services in New York State 49-50 (DOJ filed Dec. 9, 1994) (“MCI MTV Comments”) (Ex. 8 hereto).

<sup>12</sup> See also BT Form 20-F at 17 (noting proposal to “use an incremental costs, as opposed to a fully allocated costs, approach to setting interconnection prices”).

that its proposed price caps “will give BT considerably more flexibility than it has now in setting [interconnection] charges” and that this “flexibility can of course be abused: BT could, for example, seek to increase charges for services (and for network components within services) which BT itself uses less frequently than other operators and at the same time to lower retail prices for services using these network components, thus squeezing operators’ margins.” OFTEL Pricing Proposals ¶ 2.21. OFTEL thus would not rely exclusively upon its flexible price cap plan to prevent cost misallocation or price squeezes, but invokes as well its other “powers to deal effectively and quickly with potential abuses of market power.” Id. ¶ 2.22.

In contrast, the Commission has confirmed that its own price caps regime, with separate upper and lower bounds for different service baskets and, within each basket, for service categories, sharply restricts a carrier’s ability to engage in price manipulation. Telephone Co.-Cable Television Cross-Ownership Rules, 10 FCC Rcd 244, 318 (1994). In order for a Bell company to price above the cap, for example, it must provide “extensive support materials” to satisfy the “stringent review standards.” Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786, 6823, ¶ 303 (1990), aff’d sub nom. National Rural Telecom Ass’n v. Commission, 988 F.2d 174 (D.C. Cir. 1993). “Above-cap filings will be found lawful only in the unlikely event that [the Commission’s access] rules have the effect of denying a LEC the opportunity to attract capital and continue to operate.” Id. at 6823, ¶ 304. No Bell company has ever made an above-cap tariff filing. Area-wide rate averaging requirements and the “just and reasonable” rates requirement of 47 U.S.C. § 202(a) further restrict a carrier’s ability to raise and lower particular rates strategically. Telephone Co.-Cable Television Cross-Ownership Rules, 10 FCC Rcd at 318, ¶ 154. Accordingly, unlike OFTEL, the Commission is able to rely upon its

“price cap regulatory regime” as its “primary means of protecting” against anticompetitive conduct. *Id.* at 323, ¶166.

Separate Subsidiary Requirements. Moving away from rate regulation, the applicants assert that BT is subject to various other conditions “which read much like detailed FCC regulations.” Applications and Notification at 37. The Bell companies, of course, are and will be subject to the actual Commission regulations that BT and MCI use as their yardstick.

For instance, while BT/MCI intends immediately to use the same corporate entity to offer local, intercity and international service in the United Kingdom, Bell companies will, for at minimum a three-year period, provide in-region interLATA services pursuant to the structural safeguards of section 272, backed up by implementing regulations “designed to prevent improper cost allocation between the BOC and its section 272 affiliate and discrimination by the BOC in favor of its section 272 affiliate.” First Report and Order and Further Notice of Proposed Rulemaking, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended, FCC 96-489, CC Dkt No. 96-149, at ¶ 15 (rel. Dec. 23, 1996) (“Non-Accounting Safeguards Order”).

Under the 1996 Act, long distance operations must be conducted by a separate affiliate that

shall operate independently from the Bell operating company; shall maintain books, records, and accounts . . . separate from . . . the Bell operating company; shall have separate officers, directors, and employees . . . ; may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company; and shall conduct all transactions with the Bell operating company . . . on an arm’s length basis . . . .

§ 272(b). The Commission has interpreted section 272 to forbid joint ownership, by a Bell company and its long-distance affiliate, of transmission and switching facilities, as well the land and buildings where the facilities are located. Non-Accounting Safeguards Order ¶ 158. Nor could a Bell company and its long distance affiliate, under the Commission's new rules, use the same personnel to operate, install or maintain, their facilities. Id. ¶ 163. Moreover, where a Bell company and its long-distance affiliate share limited in-house services, they must not only comply with the non-discrimination safeguards of section 272 (transacting on an "arm's length" basis in a nondiscriminatory manner), but also reduce their agreement to writing and make it available for public inspection. Accounting Safeguards Order ¶ 182.

In proceedings to implement section 272, MCI urged the Commission to prohibit the joint ownership of any property and the sharing of even administrative services. Non-Accounting Safeguards Order ¶ 154 & nn.372, 374. Yet here MCI is arguing that BT's local, intercity and international operations can be operated by a single corporate entity without any risk to competition in the United Kingdom. MCI's assertions in this proceeding likely are correct, and to the extent that the Commission determines they are true for BT in the United Kingdom, they also are true for the Bell companies in the United States. MCI's contrived speculation about hypothetical Bell company misdeeds can be put to rest.

Accounting Rules. BT and MCI note that in March 1995, OFTEL and BT agreed to new accounting rules for BT's "regulatory businesses." Applications and Notification at 37; see also BT Form 20-F at 18. Under the new agreement, BT must keep separate accounts and issue separate financial statements for various activities. OFTEL has authority to investigate any

alleged cross-subsidies. The applicants indicate that these accounting rules are sufficient to prevent cost misallocation.

The accounting safeguards that will be applied to the Bell companies under the 1996 Act match or exceed those recently imposed upon BT in every respect. Section 272(b) of the Act requires that Bell company long distance subsidiaries conduct all transactions with affiliated Bell operating companies on an arm's-length basis, in writing, and subject to public review. In order to satisfy the "reduced to writing and available for public inspection" requirement of section 272(b)(5), the Commission requires the separate affiliate "at a minimum, to provide a detailed written description of the asset or service transferred and the terms and conditions of the transaction on the Internet within 10 days of the transaction." Accounting Safeguards Order ¶ 122 (setting forth additional requirements as well). The operating company must charge its long distance affiliate a publicly available rate for any services it provides. § 272(e). And, any non-tariffed affiliate transactions that are not subject to prevailing company prices must be recorded "at the higher of cost and estimated fair market value when the carrier is the seller or transferor, and at the lower of cost and estimated fair market value when the carrier is the buyer or transferee." Accounting Safeguards Order ¶ 147.

In addition, the Bell company must "obtain and pay for a joint Federal/State audit every 2 years conducted by an independent auditor," who will have access to the business records of both the local and long distance affiliate. § 272(d)(1), (3). These audits will be reviewed by the Commission and appropriate state commissions, and will be available for public inspection so that interexchange carriers and others can assure themselves that the Bell company is in compliance. § 272(d)(2).

Unlike OFTEL's recent agreement with BT, the Commission's accounting rules are stable and have a proven track record. The Commission "now ha[s] had approximately ten years experience with [its] cost allocation and affiliate transactions regime." Accounting Safeguards Order ¶ 109.<sup>13</sup> Moreover, the Commission recently explained that its "cost allocation and affiliate transactions rules, in combination with audits, tariff review, and the complaint process, have proven successful at protecting regulated ratepayers from bearing the risks and costs of incumbent local exchange carriers' competitive ventures." Accounting Safeguards Order ¶ 25. The Commission reasoned that because these rules "have proven generally effective" there was "no reason to require a change to a different system" in the aftermath of the 1996 Act. Id. ¶¶ 28, 108.

Once again, despite its claims that OFTEL's newer, less rigorous rules, are adequate to prevent BT from misallocating costs, MCI has argued that the Commission "must adopt more stringent affiliate transactions rules to account for the . . . increased incentives and opportunities for incumbent local exchange carriers to shift costs." Accounting Safeguards Order ¶ 104. The only explanation is that MCI's views about the adequacy of regulatory safeguards depend upon whether the safeguards burden MCI or its potential competitors.

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<sup>13</sup> See Separation of Costs of Regulated Tel. Serv. From Costs of Nonregulated Activities, 2 FCC Rcd 1298, 1300, ¶ 7, 1304, ¶ 47 (1986) (adopting accounting rules and requiring BOCs to file cost allocation manuals showing how they will implement the prescribed standards); see also Automated Reporting Requirements for Certain Class A and Tier 1 Tel. Cos., 2 FCC Rcd 5770 (1987) (requiring carriers to file new computerized records aimed at detecting improper cost-shifting); Policy and Rules Concerning Rates for Dominant Carriers, 6 FCC Rcd 2637, 2714, ¶ 168 (1991) ("requir[ing] any exchange carrier offering interexchange service to impute to itself the same costs that it uses to develop the access rates that it charges its interexchange customers").

### **C. Protections Against Technical Discrimination**

BT, the applicants stress, is subject to a general non-discrimination requirement. Applications and Notification at 22-23. Bell companies are too, but they also have lived under a detailed set of equal access rules that have been hammered out by the Commission over more than a decade.<sup>14</sup> The 1996 Act preserves and expands these requirements. §§ 251(g), 272(c), (e). The Commission interprets the statute as requiring “at minimum” that Bell operating companies “must treat all other entities in the same manner as they treat their affiliates, and must provide and procure goods, services, facilities and information to and from those other entities under the same terms, conditions, and rates.” Non-Accounting Safeguards NPRM ¶ 73; Non-Accounting Safeguards Order ¶¶ 198, 202. The Commission even has held that when a Bell company develops a new service for or with its long distance affiliate, “it must develop new services for or with unaffiliated entities in the same manner.” Non-Accounting Safeguards Order ¶ 210. And as already noted, no Bell company could get away with the unequal dialing regime that BT employs. See supra p. 6.

BT and MCI further explain that since 1994, BT has had to disclose technical information regarding its network to interconnectors. Applications and Notification at 37-38. Again, the Bell companies have complied with such network disclosure requirements for more than a decade. Under the Commission’s “All Carrier Rule,” carriers must make any information necessary to carrier interconnection available “in a timely manner and on a reasonable basis.” Computer and

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<sup>14</sup> See MTS and WATS Market Structure Phase III, 100 F.C.C.2d 860, 877 (1985) (requiring all local exchange carriers to undertake equal access conversions); 6 FCC Rcd at 2714 ¶ 168 (requiring LECs that provide interexchange service to impute “the same costs that it uses to develop the access rates that it charges its interexchange customers”).

Business Equipment Mfrs. Ass'n, 93 F.C.C.2d 1226, 1228, ¶ 6 (1983); see also Amendment to Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), 104 F.C.C.2d 958, 1080-86, ¶¶ 246-55 (1986). The Commission also has adopted specific rules governing the disclosure of information for the interconnection of customer premises equipment, 47 CFR §§ 68.110(a), (b), and enhanced services, id. § 64.702. The 1996 Act, continuing the Commission's requirements, imposes upon Bell companies a "duty to provide reasonable public notice of changes in the information necessary for the transmission and routing of services using that local exchange carrier's facilities or networks." 47 U.S.C. § 251(c)(5). The Commission has confirmed that it "will not hesitate" to impose one of "a range of other penalties . . . to ensure . . . compliance" with this provision. Second Report and Order, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, at ¶ 248 (rel. Aug. 8, 1996). Moreover, the Commission recently concluded that its "current network disclosure rules are sufficient to meet the requirement of section 272(e)(2) that [Bell companies] disclose any 'information concerning . . . exchange access' on a nondiscriminatory basis." Non-Accounting Safeguards Order ¶ 253.

In addition, the Bell companies have long complied with detailed disclosure rules and interconnection monitoring requirements that facilitate detection of technical discrimination. Under Commission rules, the call set-up time, transmission quality, and call completion record of each Bell company not only is subject to direct monitoring by interexchange carriers, but also

must be reported to the Commission.<sup>15</sup> The 1996 act's auditing provisions impose an additional reporting duty. § 272(ᐃ).

As the Commission has explained, "the reporting requirements required by the 1996 Act, those required under state law, and those that may be incorporated into interconnection agreements negotiated in good faith between BOCs and competing carriers will collectively minimize the potential for anticompetitive conduct by the BOC and its interexchange operations," while "also facilitat[ing] detection of potential violations of the section 272 requirements." Non-Accounting Safeguards Order ¶ 327.

Not surprisingly, MCI has urged even more stringent restrictions on the Bell companies. Non-Accounting Safeguards Order ¶ 319 & n.845, ¶ 320 & n.849. But given the Commission's findings regarding its own rules and MCI's faith in the adequacy of BT's less comprehensive reporting requirements, that only shows, once again, the vacuousness of MCI's objections to Bell company interLATA entry.

#### **D. Protections Against Misuse of Confidential Information**

BT and MCI assert that by requiring BT to execute confidentiality agreements when it provides interconnection, U.K. regulators erect "fire walls" between BT's wholesale and retail businesses and prevent BT from using information that it obtains through interconnection agreements to compete against the interconnector. Applications and Notification at 38-39. As

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<sup>15</sup> See, e.g., Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786, 6827, ¶ 335 (1990) ("expand[ing] significantly our monitoring of service quality and infrastructure development"); Provision of Access for 800 Service, 6 FCC Rcd 5421, 5425, ¶ 19 (1991) (prescribing mean set-up time of 2.5 seconds or less).

noted above, however, the separate subsidiary requirements of section 272 erect much more stringent barriers for all purposes, not just confidentiality.

The applicants further argue that BT's inability to disclose customer information (such as size of local customers' bills and the services they use) to those BT employees engaged in competitive businesses prevents BT from gaining an unfair advantage. Applications and Notification at 39. Section 272(c)(1) establishes a similar requirement of non-discrimination in the provision of local customer information to long distance carriers. See Non-Accounting Safeguards Order ¶ 222. Again, moreover, Congress has built on a track record of successful Commission regulation, for the Commission's rules governing use of Customer Proprietary Network Information ("CPNI") already ensure that the Bell companies do not have an unfair advantage in markets such as enhanced services.<sup>16</sup>

#### **E. Additional Penalties**

MCI and BT include among their list of critical safeguards the risk of damage suits and license enforcement orders; the possibility that the Director General of Telecommunications (perhaps with the aid of the Monopolies & Mergers Commission and/or the Office of Fair Trading) will amend BT's license, elicit additional guarantees, or enjoin anticompetitive conduct; and finally, the chance that third parties could sue for damages or injunctive relief if BT were to violate the European Community Treaty. Applications and Notification at 39-42.

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<sup>16</sup> Amendment to Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry), 2 FCC Rcd 3072, 3082 (1987); Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, 6 FCC Rcd 7571 (1991).

Here too, the analogous protections against Bell company misconduct are at least as weighty. Common carriers that violate any provision of the Communications Act of 1934 must compensate injured parties for the amount of their injuries plus attorneys fees. 47 U.S.C. §§ 206-207. In addition, section 220(e) of the Communications Act establishes criminal penalties for false entries in the books of a common carrier — a strong deterrent against purposeful violations of the accounting requirements described above. Sections 501 through 504 allow for additional penalties — including imprisonment, fines, and forfeiture — for knowing violations of any statutory or regulatory provision. Moreover, if the Commission determines that a Bell company “has ceased to meet any of the conditions required for” interLATA entry, it may revoke interLATA authority under section 271(d)(6). These specific statutory and regulatory protections are backed up by federal and state antitrust laws, which provide for such penalties as treble damages and imprisonment.

In the United States, these potential sanctions would be imposed by independent federal and state regulators whose only interest lies with protecting competition and fulfilling the statutory designs of Congress and state legislatures. Indeed, the Communications Act of 1934 prohibits any person employed by the Commission from owning “stocks, bonds, or other securities,” or having any other financial interest in, any entity significantly regulated by the Commission. 47 U.S.C. § 154(b). In an effort to match this, MCI and BT rely upon the Commission’s finding that the United Kingdom has a regulatory authority that is independent of BT. Applications and Notification at 36. Yet the British government owns bonds in BT worth approximately £500 million and holds a “Special Share” in BT that gives it special management rights. BT Form 20-F, at 21. The U.S. regulatory regime to which Bell companies are subject

thus surpasses the U.K.'s analog not only in substantive rigor, but also in institutional independence.

## **II. THE POTENTIAL BENEFITS OF THE MERGER ARE LESS THAN THOSE OF BELL COMPANY ENTRY INTO IN-REGION LONG DISTANCE**

In its public interest analysis the Commission must evaluate not only the protections against misconduct by BT/MCI — evaluating U.K. domestic markets that are less open than U.S. local markets and U.K. regulatory safeguards less powerful than their U.S. counterparts — but also the affirmative benefits of the proposed merger. See Sprint Corporation Petition for Declaratory Ruling Concerning Section 310(b)(4) and (d) and the Public Interest Requirements of the Communications Act of 1934, as Amended, 11 FCC Rcd 1850, 1865, ¶ 88 (1995). Here too, the claimed benefits of the foreign acquisition of MCI fall short of the public benefits that will be gained by allowing the Bell companies to augment interLATA competition in their home regions.

The claimed benefits of the merger are synergies between local and interexchange operations, the infusion of additional resources into U.S. telecommunications markets, and greater opportunities for one-stop shopping. Applications and Notification at 8-14. These are basically the same public benefits that would follow from Bell company interLATA entry pursuant to section 271. The Commission, for example, has explained that Bell companies entering the long distance business in their home regions “can offer . . . the ability for consumers to purchase local, intraLATA and interLATA telecommunications services from a single provider (i.e., ‘one stop shopping’), and other advantages of vertical integration.”<sup>17</sup> Incumbent

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<sup>17</sup> Non-Accounting Safeguards NPRM at ¶ 6.